

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

IN RE:	\$	
	\$	
HARBOR FINANCIAL GROUP, INC.,	\$	CASE NO. 99-37255-SAF-7
et al.,	\$	(Jointly Administered)
DEBTORS.	\$	
	\$	
JOHN H. LITZLER, TRUSTEE,	\$	
PLAINTIFF,	\$	
	\$	
VS.	\$	ADVERSARY NO. 01-3455
	\$	
NETWORK SERVICES NOW, INC.,	\$	
TURTLE CREEK TOWER and PC AGE,	\$	
INC.,	\$	
DEFENDANTS.	\$	

MEMORANDUM OPINION AND ORDER

John H. Litzler, the Chapter 7 trustee of the bankruptcy estates of Harbor Financial Group, Inc., et. al., moves the court for summary judgment recovering \$61,466.25 from Network Services Now, Inc. Network opposes the motion and, in turn, cross-moves for summary judgment dismissing the complaint. The court conducted a hearing on the motions on February 27, 2002.

Summary judgment is proper if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, and other matters presented to the court show that there is no genuine issue of material fact and that the moving party is entitled to a judgment as a matter of law.

Celotex Corp. v. Catrett, 477 U.S. 317, 322-23 (1986); Anderson

v. Liberty Lobby Inc., 477 U.S. 242, 250 (1986); Washington v. Armstrong World Indus., 839 F.2d 1121, 1122 (5th Cir. 1988). On a summary judgment motion the inferences to be drawn from the underlying facts must be viewed in the light most favorable to the party opposing the motion. Anderson, 477 U.S. at 255. A factual dispute bars summary judgment only when the disputed fact is determinative under governing law. Anderson, 477 U.S. at 250.

The movant bears the initial burden of articulating the basis for its motion and identifying evidence which shows that there is no genuine issue of material fact. Celotex, 477 U.S. at 322. The respondent may not rest on the mere allegations or denials in its pleadings but must set forth specific facts showing that there is a genuine issue for trial. Matsushita Electric Indus. Co., Ltd. v. Zenith Radio Corp., 475 U.S. 574, 587 (1986). The court applies the same standards to the cross-motion for summary judgment.

On September 24, 1999, Harbor Financial Mortgage Corp; NAF, Inc., f/k/a New American Financial, Inc.; and CalCap, Inc., f/k/a/ Caledon Capital, Inc., collectively referred to as Harbor for purposes of this memorandum opinion, entered into an Asset Purchase Agreement with Aegis Mortgage Corp. Aegis agreed to purchase assets of the Harbor entities.

Harbor owed Network \$61,466.25. According to Michael C. Balog, an Aegis Executive Vice President and its General Counsel,

in anticipation of the closing of the transaction and to preserve the viability of the Harbor entity, Aegis paid Network the \$61,466.25 owed by Harbor. The transaction closed on October 5, 1999.

On October 14, 1999, the Harbor entities filed their petitions for relief under the Bankruptcy Code.

Litzler contends that Network received an indirect preference because Aegis paid the antecedent Harbor debt. Litzler argues that the preference is avoidable under 11 U.S.C. §547, and recoverable from Network, by a money judgment under 11 U.S.C. §550.

There are no genuine issues of material fact: (1) that Aegis paid the Harbor debt to Network within 90 days of the Harbor bankruptcy petitions; (2) that Aegis made the payment to Network as a creditor of Harbor; (3) that Aegis made the payment for an antecedent debt owed by Harbor to Network; and (4) that Harbor was insolvent at the time of the payment. There is also no genuine issue of material fact that Aegis paid Network in full, whereas Harbor's other unsecured creditors will not be paid in full by the Chapter 7 trustee.

However, §547(b) provides that the trustee may only avoid a "transfer of an interest of the debtor in property." Litzler contends that the Aegis payment amounted to a transfer of an interest of Harbor in property. Relying on In re Conard Corp.,

806 F.2d 610, 612 (5th Cir. 1986), Litzler asserts that Aegis made the payment as part of the consideration tendered for Harbor's assets. In his affidavit, Balog averred that the payment of Harbor creditors such as Network "affected the purchase price [that] Aegis was willing to pay." Balog Aff. ¶10. Balog further averred that the cash purchase price that Aegis agreed to pay for the assets was less than the price Aegis would have paid, had it not assumed certain liabilities and paid certain debts. Balog Aff. ¶9. Litzler argues therefrom that the payment amounted to a reduction of the purchase price and, under Conard, a transfer of an interest of the debtor in property.

But, Network counters that Litzler misreads the Asset Purchase Agreement and the Balog affidavit. Under the Asset Purchase Agreement, certain Harbor liabilities paid by Aegis, which includes the Network debt, "shall be offset against amounts payable to [Harbor] pursuant to Section 2.2(a)(ii) and Section 2.2(a)(iv) and not against the amount payable at Closing pursuant to Section 2.2(a)(i)." Asset Purchase Agreement, §2.2(b). Sections 2.2(a)(ii) and (a)(iv) provide for contingent profitability payments for business and company profitability for six month periods beginning with the period ending March 31, 2000. Under the express terms of the agreement, Aegis could offset the payment to Network from payments due to Harbor based on the profitability calculations beginning after March 31, 2000,

but not from the purchase price due at closing on October 5, 1999.

In accord with the provisions of the agreement, Balog averred that Aegis paid Network "not as consideration under the Asset Purchase Agreement but because such payments were necessary to preserve the viability of the assets [Harbor] proposed to sell and convey to Aegis pursuant to the Asset Purchase Agreement." Balog Aff. ¶7.

Network contends that, as a result, the purchase price was not directly reduced on a dollar by dollar basis by the Network payment, and, consequently, the transfer does not meet the Conard test. Network argues that Aegis had no right to offset the payment until after March 31, 2000, which was post-petition. Consequently, even though Aegis paid the debt during the preference period, it did not do so with an interest of the debtor in property, and it could not have indirectly affected an interest of the debtor in property until it had a right to offset the payment under the Asset Purchase Agreement, which occurred post-petition and hence not within the preference period. At closing, on October 5, 1999, Aegis could not offset the Network payment against the purchase price due at closing. Accordingly, Network contends that the transfer did not involve the transfer of an interest of the debtor in property.

In Conard, a Pizza Hut entity purchased Pizza Hut

restaurants from the debtors for consideration that included the assumption of the debtors' obligations on a note to a third party. The purchaser made several note payments. In Conard, the Fifth Circuit recognized that the "assumption by a purchaser of assets from the debtor of the debtor's pre-existing note obligation to a third party was a voidable preference." 806 F.2d at 612. The Circuit affirmed the avoidance of the assumption to the extent that it permitted the payment of monies, otherwise owed to the debtors as part of the purchase price, to be paid to the noteholders. As a result, the purchaser had to make payments to the bankruptcy trustee.

The Court reasoned that, "[a]s a result of executing the Assumption of Debt Agreement, the debtors transferred to the [note holders] the debtors' right to receive from [the purchaser] so much of the sales price . . . as was needed to reimburse [the note holders] on their note." 806 F.2d at 612. Even though the purchaser paid the note holders directly, the payment reduced the purchase price received by the debtors and, hence, the Circuit reasoned, amounted to an indirect preference. By avoiding the assumption, the Court, in effect, restored the purchase price by redirecting the purchaser's payments from the note holders to the trustee. 806 F.2d at 613.

In his affidavit, Balog recognized the business reality that the payment of Harbor liabilities had an effect on the purchase

price. Aegis negotiated the deal with the expectation that it would pay certain Harbor liabilities. But, under the Asset Purchase Agreement, the parties structured the transaction to require a certain payment calculation at closing, as well as certain payments over time after closing, based on profitability formulas. The parties agreed that the Network payment, and others, could only be offset by Aegis against those future payments when they became due. The Asset Purchase Agreement expressly states that the Network payment could not be offset from the amount due at closing. And, consistent with that provision, Balog avers that Aegis did not pay Harbor's debt to Network as consideration under the Asset Purchase Agreement. Unlike Conard, the Aegis payment to Network did not create, result in or equate to a credit at closing of part of the consideration for the purchase of the debtor's assets. The payment of Network did not reduce the payment due at closing. Further, unlike Conard, avoiding the agreement of Aegis to pay Network would not have increased the amount due by Aegis at closing.

Aegis paid Network based on a business decision to preserve the value of the assets that it would acquire under the Asset Purchase Agreement. In return, under the agreement, Aegis had the opportunity to offset that sum against payments that would be due to Harbor under a profitability formula beginning March 31,

2000, post-petition.

There is no genuine issue of material fact that under the Asset Purchase Agreement, Aegis had no right to offset the Network payment from any amount due to Harbor at closing on October 5, 1999. Under Conard, therefore, the payment to Network pre-petition cannot be deemed to be a transfer of an interest of the debtor in property.

Because the payment did not amount to the transfer of an interest of Harbor in property effective at the closing of the sale on October 5, 1999, the trustee cannot establish a "transfer of an interest of the debtor in property" thereby precluding the avoidance of the Network payment by Aegis under §547.

Aegis is entitled to a summary judgment dismissing the complaint.

Based on the foregoing,

IT IS ORDERED that the motion of John H. Litzler for summary judgment is **DENIED**.

IT IS FURTHER ORDERED that the motion of Network Services Now, Inc., for summary judgment is **GRANTED**.

Counsel for Network Services Now, Inc., shall prepare a final order dismissing the complaint.

Signed this _____ day of March, 2002.

Steven A. Felsenthal

United States Bankruptcy Judge